

Montana.
1.72322 Legislature.
2pdpb Office of the
87 In-state bidders
preference,
Department of
Administration 6/5

STATE OF MONTANA

AUG 23 1988

MONTANA STATE LIBRARY
1015 E. 6th AVE.
HELENA, MONTANA 59620

State of Montana
Office of the Legislative Auditor

PERFORMANCE AUDIT

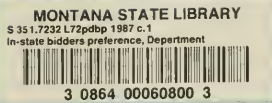
IN-STATE BIDDERS PREFERENCE
Department of Administration

This report discusses the effects of Montana's in-state bidders preference law. The report recommendation addresses changing the definition of a Montana resident vendor.

PLEASE RETURN



Direct comments/inquiries to:
Office of the Legislative Auditor
Room 135, State Capitol
Helena, Montana 59620



PERFORMANCE AUDITS

Performance audits conducted by the Office of the Legislative Auditor are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy. In performing the audit work, the audit staff uses audit standards set forth by the United States General Accounting Office.

Members of the performance audit staff hold degrees in disciplines appropriate to the audit process. Areas of expertise include business and public administration, statistics, economics, computer science, and engineering.

Performance audits are performed at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of four members of the Senate and four members of the House of Representatives.

LEGISLATIVE AUDIT COMMITTEE

Senator Judy Jacobson, Chairman
Senator Delwyn Gage
Senator Tom Keating
Senator Ted Neuman

Representative John Cobb, Vice Chairman
Representative Dorothy Bradley
Representative Harry Fritz
Representative Bruce Simon

AUG 25 1988

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122



SCOTT A. SEACAT
LEGISLATIVE AUDITOR

March 1988

DEPUTY LEGISLATIVE AUDITORS:

JAMES GILLET
FINANCIAL COMPLIANCE AUDITS

JIM PELLEGRINI
PERFORMANCE AUDITS

LEGAL COUNSEL:

JOHN W. NORTHEY

The Legislative Audit Committee
of the Montana Legislature:

This is our performance audit of Montana's in-state bidders preference law administered by the Department of Administration.

This report discusses the effect of the law and contains our recommendation pertaining to changing the definition of a Montana resident vendor. The Department of Administration response is contained at the end of the report.

We wish to express our appreciation to the department and Purchasing Bureau staff for their cooperation and assistance.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Scott A. Seacat".
Scott A. Seacat
Legislative Auditor

PERFORMANCE AUDIT REPORT
IN-STATE BIDDERS PREFERENCE
DEPARTMENT OF ADMINISTRATION
March 1988
Report Number 87P-40

Members of the audit staff involved in this audit were Jim Nelson, Mary Reynolds, and Kent Rice. Additional information on the audit can be obtained by contacting the Office of the Legislative Auditor at (406) 444-3122.

TABLE OF CONTENTS

	<u>Page</u>
List of Illustrations	iii
Administrative Officials	iv
Chapter I	
<u>Introduction</u>	
Scope of Audit	1
Compliance	3
Management Controls	3
Chapter II	
<u>Background</u>	
Montana's Vendor Preference	5
In-State Bidders Preference in Other States	6
Constitutionality of Bidders Preference Laws	8
Purpose of In-State Bidders Preference Laws	8
Application of the Preference	9
Use of Federal Funds for Purchases	10
Effect of the Preference	10
Chapter III	
<u>Options for Changing the In-State Bidders Preference Law</u>	
Change the Definition of a Montana Resident	15
Conclusion	19
Increase the Preference	19
Questionnaire Responses	21
Conclusion	22
Eliminate the Preference	23
Limited Number of Bids Affected by the Preference	24
Vendors Total Business versus State Business	25
Preference Does Not Discourage Vendors	26

TABLE OF CONTENTS
(Continued)

	<u>Page</u>
Impact on Contractors	27
Conclusion	28
Summary	28
Agency Response	30

LIST OF ILLUSTRATIONS

<u>No.</u>		<u>Page</u>
1	Summary of In-State Preference Practices for General Goods and Services	7
2	Response of Vendors Eligible for the Preference to Question Concerning Intent of Law	9
3	Dollar Amount to Each Type of Vendor in FY 1986-87	11
4	Total Dollars Spent in FY 1986-87	13
5	Comparison of Vendors Eligible for the Preference and Vendors with Montana Addresses Not Eligible for the Preference	16
6	Sales Distribution If Not for the Preference in FY 1986-87	18
7	Effect of the Preference on the Various Types of Vendors	21
8	Amount Preference Vendors Think the Preference Should Be	22
9	Summary of Effect on IFBs Processed in FY 1986-87	24
10	Sales to the State in Relation to Total Dollar Sales for Vendors Eligible for the Preference	25
11	Responses to Question Whether Preference Has Discouraged Bidding	27

ADMINISTRATIVE OFFICIALS
Department of Administration

Ellen Feaver
Dave Ashley

Director
Deputy Director

Procurement and Printing Division

Mike Muszkiewicz
Tony Herbert

Administrator
Acting Administrator

Purchasing Bureau

Earl Fred

Chief

CHAPTER I

INTRODUCTION

The Legislative Audit Committee requested performance audits of selected areas of the Purchasing Bureau, Department of Administration. This particular report addresses our performance audit work concerning Montana's in-state bidders preference law, Title 18, chapter 1, part 1, MCA, and the administration of the law.

The in-state bidders preference law pertains to the awarding of contracts for materials, supplies, equipment, construction, repair, and public works of all kinds. The law allows a contract to be awarded to the lowest responsible bidder who is a resident of the state of Montana and whose bid is not more than three percent higher than that of the lowest responsible bidder who is a non-resident of this state.

The objectives of our performance audit were:

1. To determine the intent and effects of the in-state bidders preference law, including:
 - a. dollar cost to the state;
 - b. if the preference keeps non-resident vendors from bidding on Montana contracts; and
 - c. if the definition of in-state resident is appropriate.
2. To determine if the in-state bidders preference is being applied consistently and correctly.

SCOPE OF AUDIT

The audit was conducted in accordance with generally accepted governmental performance auditing standards.

We reviewed sealed bids for goods and services requested from Requisition Time Schedules and individual requisitions processed through the Purchasing Bureau in fiscal year 1986-87. We determined the number of times the preference affected a bid, the dollar effect to the state, and the vendors affected by the preference. We also determined the number of vendors submitting bids, and whether the vendor was from out-of-state, had a Montana address but was not eligible for the preference, or was eligible for in-state bidders preference. Our review did not include vendors submitting bids for

printing, or any printing contracts. The Publications and Graphics Bureau, Department of Administration, awards printing contracts.

Purchase orders were examined to determine the dollar amount of awarded contracts going to individual vendors and to determine types of vendors (i.e., out-of-state vendors, vendors with Montana addresses not eligible for the preference, and vendors eligible for the preference).

The Purchasing Bureau delegates purchasing authority over \$2,000 to agencies upon request by agency personnel. These agencies must use sealed bids to obtain goods and services valued over \$2,000 not on the Requisition Time Schedule or term contracts. Because of delegated purchasing authority, agencies make purchases without going through the Department of Administration. We did not review other agencies' purchasing practices for delegated purchases, or determine the dollar amount of goods and services purchased.

We reviewed a sample of term contracts to determine if the in-state bidders preference was applied. We also determined the approximate dollar value of sales for a sample of term contracts. We did not determine the dollar value for all term contracts since the purchases are made by each agency and information is not available at the Purchasing Bureau at this time.

We examined a sample of files at the Department of Highways, and the Architecture and Engineering Division, Department of Administration, to determine if the in-state bidders preference had any effect on construction of state funded highways and buildings. The Department of Highways awards construction contracts for state highways. The Architecture and Engineering Division lets contracts for construction of state buildings. We did not determine the total dollar amount of construction projects let by the Department of Highways, and the Architecture and Engineering Division.

Local governments and school districts are statutorily required to apply the in-state bidders preference law (Section 18-1-102, MCA). We did not specifically audit local governments and school districts for compliance with that statute. We contacted the Local Government Services Division, Department of Commerce, and were informed very few bids involve out-of-state vendors so the preference is rarely applied.

We sent questionnaires to a sample of: (1) vendors who deal with the Purchasing Bureau; (2) vendors from Montana and other states who do not deal

with the Purchasing Bureau; (3) contractors with Montana addresses; and (4) contractors from surrounding states. We also reviewed affidavits submitted to the Purchasing Bureau by vendors desiring to do business with state government.

We gathered information from national purchasing organizations and other Western states concerning in-state bidders preference laws.

COMPLIANCE

While at the Purchasing Bureau we examined compliance with the in-state bidders preference law. This examination included bureau application of the in-state bidders preference to determine which vendor was to be awarded the bid, and the determination of which vendors are eligible for the preference. We found the Purchasing Bureau was generally in compliance with state law. For areas we did not specifically test for compliance, nothing came to our attention that would indicate significant instances of agency noncompliance.

MANAGEMENT CONTROLS

Information gathered during the audit indicates management controls over the in-state bidders preference law at the Purchasing Bureau are adequate. Bureau personnel are writing policies and procedures for the bureau buyers to follow in determining who is eligible for the in-state bidders preference. We found the preference was applied correctly for 2,776 of the 2,787 bids processed for Requisition Time Schedules and individual requisitions in fiscal year 1986-87. The process was automated in November 1987, so minor mistakes in the application of the preference should no longer occur. Bureau personnel have plans for gathering information showing the number of times the preference has been applied, its effect on the state, etc. This information will be useful for legislators and other people interested in the effects of the in-state bidders preference. We believe the bureau is doing a good job in managing the in-state bidders preference law.

CHAPTER II

BACKGROUND

The Purchasing Bureau, Department of Administration, procures a large part of the goods and services (excluding printing and construction) for state government. Agencies request the purchase of goods and services by submitting a requisition to the Purchasing Bureau. Upon receipt of the requisition the purchasing agent (buyer) will either begin purchasing procedures immediately, or put the requisition with requisitions from other agencies for similar items for scheduled purchases (Requisition Time Schedule purchases).

The Requisition Time Schedule (RTS) is a calendar of dates on which requisitions for specific goods and services are due in the Purchasing Bureau. The RTS is used to purchase goods and services identified as having a significant cost savings when purchased in quantity.

Goods and services can also be purchased from a term contract established by the Purchasing Bureau with vendors. Term contracts are for specific goods and services competitively bid by the Purchasing Bureau for the state. The successful bidder has the right to sell that good or service to a department or agency for a certain period of time for the price established in the contract.

Purchasing Bureau buyers use a formal sealed bid process called the Invitation for Bid (IFB) for purchases over \$2,000. This includes term contracts, Requisition Time Schedule goods and services, and individual requisition goods and services.

All these methods of purchasing goods and services involve soliciting bids from Montana vendors and from out-of-state vendors who request to do business with state government. Montana vendors are: (1) those vendors eligible for the preference; and (2) those vendors with a Montana address but not eligible for the preference primarily because the companies are incorporated in another state.

For fiscal year 1986-87 the bureau used 544 IFBs to purchase goods and services on the RTS and on individual requisitions. The Purchasing Bureau obtained approximately \$16 million in goods and services through the sealed bid process for agencies in fiscal year 1986-87. Term contract sales, direct

purchases by individual agencies, printing contracts, and construction projects are not included in the \$16 million.

MONTANA'S VENDOR PREFERENCE

Montana's present in-state preference law was enacted in 1961. The law allowed a two percent preference for awarding contracts for materials, supplies, equipment, construction, repair, and public works of all kinds. State and local governments, and school districts were all required to apply the preference.

In 1969, the legislature raised the preference to three percent, and applied a preference to materials, supplies, or equipment manufactured or produced in Montana by Montana industry and labor. In 1985 a reciprocal law for bidders on construction projects was included in the law. This addition allows Montana resident contractors a three percent preference or the preference in the state of the non-resident contractor, whichever is higher. For example, a Wyoming contractor bidding on a construction project in Montana will be penalized five percent since that is the preference in Wyoming. A North Dakota contractor will be penalized three percent since North Dakota does not have a preference.

In 1987 the Legislature increased the manufacturing preference to five percent. Vendors, whether residing in Montana or another state, selling goods manufactured in Montana receive a five percent preference for the Montana goods over vendors selling goods made in another state.

Montana law allows individuals, partnerships, and corporations to be eligible for the in-state bidders preference. According to the statute an individual must have actual residence within Montana for one or more years immediately prior to bidding to be eligible for the preference. In a partnership enterprise or an association, the majority of all partners or association members must be actual residents of the state of Montana for more than one year immediately prior to bidding. Domestic corporations organized under the laws of Montana are eligible to bid as residents unless it is shown the corporation is a wholly owned subsidiary of a foreign corporation, or the corporation was formed for the purpose of circumventing the provisions relating to residence. Purchasing Bureau buyers determine whether a vendor is eligible for the in-state bidders preference.

Montana is one of eleven states having a fixed percentage in-state bidders preference law. All state government purchases, except some agency purchases and construction projects funded partially or totally with federal funds, are subject to this law. A reciprocal preference is applied to construction projects. Montana also has a manufacturing preference. All public agencies must apply these preferences when purchasing goods and services, whether through advertising or not.

IN-STATE BIDDERS PREFERENCE IN OTHER STATES

Eleven states have a percentage in-state bidders preference applicable to the purchase of most goods and services. Twenty-one states have a reciprocal law in effect, while three states have both a reciprocal law and a fixed percentage in-state bidders preference law. Seventeen states do not have any sort of reciprocal or preference law. Reciprocal laws are designed to discourage preference laws in other states. A reciprocal law applies the preference in effect in the state of the non-resident bidder against that bidder. For example, vendors incorporated in Montana submitting bids to the State of North Dakota for a government purchase will have three percent added to their bid. One state has a retaliatory law, which means goods and services will not be purchased from any vendor from a state with a preference law.

The following illustration details the states and the types of preference laws for general goods and services in effect as of August 1987. This list does not include printing, coal, or construction projects because these items are covered in specific laws separate from laws pertaining to purchasing of general goods and services.

SUMMARY OF IN-STATE PREFERENCE PRACTICES FOR
GENERAL GOODS AND SERVICES
 (As of August 1987)

<u>State</u>	<u>Percent of Preference</u>	<u>Reciprocal Law</u>
Alabama		Yes
Alaska	3-7%	No
Arizona		No
Arkansas	5%	No
California		No
Colorado		Yes
Connecticut		No
Delaware		No
Florida		Yes
Georgia		No
Hawaii	3-10%	No
Idaho		Yes
Illinois		Yes
Indiana		No
Iowa		Yes
Kansas		Yes
Kentucky		No
Louisiana	7%	Yes
Maine		No
Maryland		Yes
Massachusetts	2-5%	No
Michigan		No
Minnesota		Yes
Mississippi		Yes
Missouri		Yes
Montana	3, 5%	No
Nebraska		Yes
Nevada		No
New Hampshire		No
New Jersey		Yes
New Mexico	5%	No
New York		No
North Carolina		No
North Dakota		Yes
Ohio	5%	No
Oklahoma	5%	Yes
Oregon		Yes
Pennsylvania		Yes*
Rhode Island		No
South Carolina	1-2%	No
South Dakota		Yes
Tennessee		No
Texas		Yes
Utah		Yes
Vermont		No
Virginia		Yes
Washington		Yes
West Virginia	2%	Yes
Wisconsin		No
Wyoming		Yes

* State has retaliatory law

Source: Department of General Services, State of Maryland
 Illustration 1

CONSTITUTIONALITY OF BIDDERS PREFERENCE LAWS

The constitutionality of preference laws has been questioned by national purchasing organizations. An article in the University of Colorado Law Review discusses the validity of in-state preference laws. The article is contained in volume 49, page 205 (1978) and is entitled "In-state Preferences in Public Contracting: State's Rights versus Economic Sectionalism". The article concludes that although in-state preference laws are constitutionally questionable, courts have not as yet struck them down on constitutional grounds. The author concludes it is only a matter of time until such preference laws are thrown out as constitutionally invalid as a burden on interstate commerce and denial of equal protection.

The article also recognized that the United State Supreme Court has never issued an opinion on the validity of preference laws. This leaves the status of validity in somewhat of a unique position of being presumed constitutional as it has not been determined otherwise, but very suspect if the issue is directly addressed by a state or United States Supreme Court. However, at the present time, based upon current court interpretations, the in-state preference laws must be presumed constitutionally valid.

PURPOSE OF IN-STATE BIDDERS PREFERENCE LAWS

Literature concerning in-state bidders preference laws indicates the purpose of such laws is to:

1. Promote industry in a state;
2. Improve the economy and employment rate in a state by allowing more money to stay in the state via jobs and increased tax base; and
3. Correct the competitive disadvantage local small businesses suffer at the hands of large national businesses.

We believe the intent of Montana's law is the same as indicated above, although intent is not specifically addressed in the statutes. Minutes from legislative committee meetings in 1961, when the law was enacted, indicate the purpose of the law is to promote industry in Montana, thus creating jobs and keeping money in the state.

The results of our questionnaire indicate vendors eligible for the preference also believe the intent is to benefit Montana's economy. One hundred thirty-four vendors eligible for the preference responded to our

questionnaire and answered our questions concerning the intent of the law. The following chart details their responses.

RESPONSE OF VENDORS ELIGIBLE FOR THE PREFERENCE
TO QUESTION CONCERNING INTENT OF LAW

	<u>Number of responses</u>	<u>Percent of 134 respondents</u>
To help Montana's economy.	94	70%
To promote business in Montana.	88	66%
To help local economies.	77	57%
To protect Montana's businesses.	75	56%
To keep competition out of Montana.	15	11%

Source: Compiled by the Office of the Legislative Auditor
Illustration 2

APPLICATION OF THE PREFERENCE

To receive the in-state bidders preference, a vendor must submit an affidavit to the Purchasing Bureau. The affidavit asks for general information such as the name and address of the bidder, and the type of business enterprise (individual, partnership, or corporation). Length of actual residence is needed if an individual or partnership is applying for the preference. If the enterprise is a corporation, the vendor must indicate the state of incorporation, and if specific information has been filed with the Secretary of State and the Department of Revenue. A vendor seeking in-state bidders preference must also indicate the principal place of business, the total number of personnel employed within Montana, whether more than fifty percent of the company's total personnel are employed within the boundaries of Montana, and whether the company is a wholly owned subsidiary of a foreign corporation. The affidavit must be notarized if the vendor is applying to be eligible for the preference.

Upon submission of the affidavit to the Purchasing Bureau, a buyer reviews the information to ensure the affidavit is complete. The buyer makes a decision as to whether the vendor is eligible for the in-state bidders

preference. The buyer will do minimal research to verify the information on the affidavit is correct.

When a vendor submits a bid, the buyer considers if the vendor is eligible for the in-state bidders preference. If the vendor is eligible, the buyer applies the three percent preference. The buyer multiplies the lowest bid from a vendor not eligible for the preference by 1.03. If the bid from the vendor eligible for the preference is lower than the new computation of the bid from the vendor not eligible for the preference, the eligible vendor receives the contract for the goods or services. For example, if a vendor not eligible for the preference bids \$2,000 for an item, and a vendor eligible for the preference bids \$2,050, the bid from the vendor not eligible is multiplied by 1.03 ($\$2,000 \times 1.03$). The result, \$2,060, is higher than the bid from the vendor eligible for the preference, so the eligible vendor receives the contract for that good or service.

Use of Federal Funds for Purchases

The in-state bidders preference law does not apply when federal funds are involved and the laws of the United States expressly prohibit the use of a preference. For example, the U.S. Department of Transportation prohibits the use of an in-state bidders preference when any federal funds are used in the construction or maintenance of a highway. This means the Montana Department of Highways cannot apply the preference when awarding a contract if partially federally funded.

The Federal Office of Management and Budget Circular A-102, a regulation for federal agencies to use in the administration of grants to state and local governments, is currently being rewritten to expressly prohibit the use of an in-state bidders preference for most federal grants. This circular is applicable to most state agencies. For example, Environmental Protection Agency grants issued to the Montana Department of Health and Environmental Sciences specifically exclude the use of an in-state bidders preference.

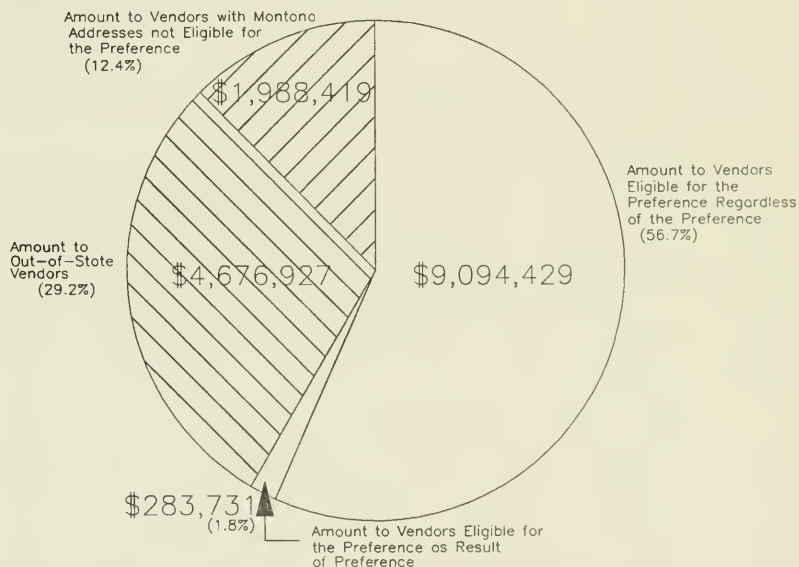
EFFECT OF THE PREFERENCE

During fiscal year 1986-87 state agencies spent approximately \$16 million purchasing Requisition Time Schedule and individual requisition goods and

services bid through the Purchasing Bureau. Vendors eligible for the preference received a total of \$9,378,160.

About \$284,000 of the \$9,400,000 paid to vendors eligible for the preference was a direct result of the preference law. If not for the preference, the \$280,000 would have been awarded to other vendors. Four thousand dollars (\$4,000) of the \$284,000 was extra cost to the state because the low bid could not be accepted. The following chart details the dollar amount paid to each type of vendor for fiscal year 1986-87.

DOLLAR AMOUNT TO EACH TYPE OF VENDOR IN FY 1986-87



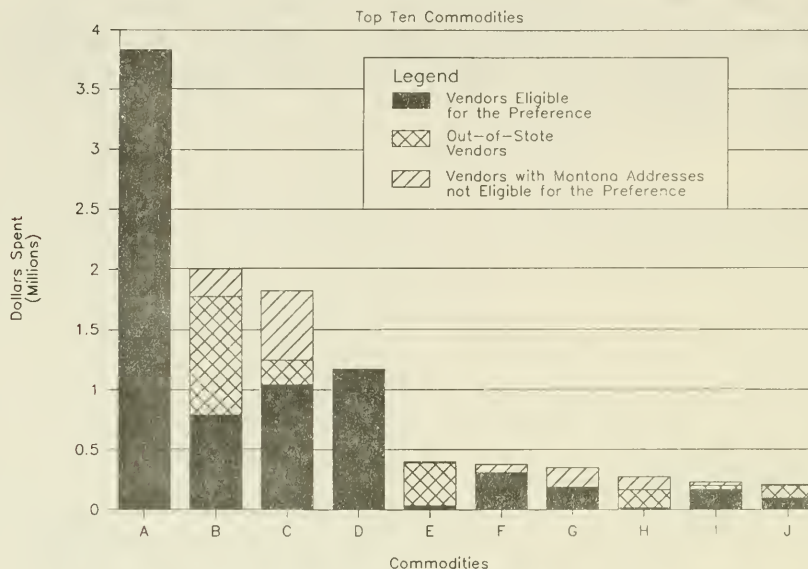
Source: Compiled by the Office of the Legislative Auditor from Purchasing Bureau records

Illustration 3

Contracts for some goods and services are awarded primarily to specific types of vendors. For example, vehicles and tractors are primarily purchased from vendors eligible for the preference, while laboratory equipment and

supplies are purchased primarily from out-of-state vendors. Illustration 4 shows the dollar amount purchased from various types of vendors for the ten goods and services categories resulting in the most dollar sales to the state in fiscal year 1986-87. These ten goods and services categories, out of approximately 50 major categories, represent 66 percent of the \$16 million spent for Requisition Time Schedule and individual requisition goods and services in fiscal year 1986-87.

TOTAL DOLLARS SPENT IN FY 1986-87



Listing of Goods and Services Categories

- | | |
|---------------------------------------|---------------------------------------|
| A - Vehicles/Tractors | F - Janitorial Services |
| B - Computer Equipment | G - Photocopiers |
| C - Food* | H - Communications |
| D - Highway Equipment | I - Building Supplies |
| E - Laboratory Equipment and Supplies | J - Athletic and Recreation Equipment |

*Food purchases only represent three months of fiscal year 1986-87. For the other nine months agencies purchased food from a term contract.

Source: Compiled by the Office of the Legislative Auditor from Purchasing Bureau records

Illustration 4

CHAPTER III

OPTIONS FOR CHANGING THE IN-STATE BIDDERS PREFERENCE LAW

We examined the purpose of the in-state bidders preference law and determined the effect of the law on state government. Although the purpose appears to be to help the Montana economy and Montana businesses, our audit work indicates the current law does not significantly affect the majority of Montana businesses (vendors) eligible for the preference.

Two hundred seventy-seven vendors eligible for the preference sold approximately \$9,400,000 in goods and services to state government for RTS and individual requisition items in fiscal year 1986-87. Two hundred eighty-four thousand dollars (\$284,000) of those purchases, from 44 of the 277 vendors, resulted from the application of the preference. These 277 vendors do not include vendors awarded term contracts or those vendors who sold goods and services directly to state agencies.

For most vendors affected by the preference, either the total dollar amount awarded for the year was small, or the amount awarded as a result of the preference was a small portion of total sales. For example, 100 percent of one vendor's sales to state government was a result of the preference, but the vendor only sold \$5,000 in goods to state government for the entire fiscal year. Another vendor was awarded contracts for over \$400,000 but only \$10,000, or 2 percent, was a result of the preference.

The preference generally does not transfer sales from an out-of-state vendor to a Montana vendor eligible for the preference. In the majority of the cases, application of the preference causes sales to transfer from a business with a Montana address not eligible for the preference to a Montana vendor eligible for the preference. Of the \$284,000 mentioned above, \$190,000 (67 percent) would have been awarded to vendors with Montana addresses not eligible for the preference. Only \$90,000 of the \$284,000 would have been awarded to out-of-state vendors if the preference had not been in effect.

The following sections discuss several options relevant to the purpose of the preference law. The sections discuss:

1. Changing the definition of a Montana resident bidder so a vendor with significant economic presence in Montana is eligible for the preference;

2. Increasing the percentage of the preference so vendors eligible for the preference sell more goods and services to state government; and
3. Eliminating the preference since the law has limited effect on most vendors eligible for the preference.

CHANGE THE DEFINITION OF A MONTANA RESIDENT

Some Montana companies contribute to Montana's economy by employing Montanans and buying or leasing capital assets yet the companies do not benefit from the preference. Statutorily, these businesses are not eligible for the preference because their companies are incorporated in another state. Currently, a company incorporated in a state other than Montana is not eligible for the in-state bidders preference.

A number of companies not eligible for the preference have employees in the state of Montana. These companies do a large amount of business with state government. The following illustration compares the number of employees and dollar volume of business with state government for ten companies with Montana addresses not eligible for the preference and ten companies eligible for the preference. These companies had the most dollar sales to state government for their respective categories (not eligible and eligible for the preference) in fiscal year 1986-87. Also shown is the value of property each business has in Montana. An "R" indicates the company owns real property in Montana while a "P" indicates the company owns personal property in Montana. All of the companies without a value indicated for real property either lease or rent a building in Montana.

COMPARISON OF VENDORS ELIGIBLE FOR THE PREFERENCE AND VENDORS
WITH MONTANA ADDRESSES NOT ELIGIBLE FOR THE PREFERENCE

Vendors Eligible for the Preference

<u>Vendor</u>	<u>Category of Vendor</u>	<u>Number of Employees in Montana</u>	<u>Property Value</u>	<u>Fiscal Year 1986-87 Sales to the State</u>
A	Auto dealer	9	\$ 111,776 P & R	\$2,672,326
B	Equipment Co.	9	\$ 90,835 P	\$1,224,870
C	Auto dealer	99	\$ 2,457 P	\$ 666,367
D	Dairy	79	\$1,907,273 P & R	\$ 382,453
E	Equipment Co.	7	\$ 3,469 P	\$ 362,935
F	Food Distr.	19	\$ 150,885 P & R	\$ 283,351
G	Computer Co.	46	\$ 52,352 P	\$ 282,621
H	Computer Co.	28	\$ 68,090 P	\$ 272,109
I	Auto Dealer	41	\$ 824,169 P & R	\$ 219,307
J	Paint Co.	69	\$1,126,369 P & R	\$ 105,762
Total		406	\$4,337,675	\$6,472,101

Vendors with Montana Addresses not Eligible for the Preference

<u>Vendor</u>	<u>Category of Vendor</u>	<u>Number of Employees in Montana</u>	<u>Property Value</u>	<u>Fiscal Year 1986-87 Sales to the State</u>
1	Food Distr.	147	\$1,573,488 P & R	\$ 483,595
2	Security Co.	111	\$ 3,190 P	\$ 184,178
3	Computer Co.	112	\$ 829,396 P	\$ 181,257
4	Photocopier Co.	26	\$ 101,832 P	\$ 170,727
5	Computer Co.	15	\$ 83,224 P	\$ 98,961
6	Printing Equip.	6	Unknown	\$ 71,991
7	Communications	14	\$ 75,467 P	\$ 57,466
8	Hauling Co.	11	\$ 95,507 P & R	\$ 51,792
9	Communications	8	\$ 25,655 P	\$ 49,019
10	Paint Co.	42	\$ 4,615 P	\$ 43,320
Total		492	\$2,792,374	\$1,392,306

Term contract sales totaling approximately \$2,070,000 are not included in the fiscal year sales figures.

P - Represents personal property R - Represents real property

Source: Compiled by the Office of the Legislative Auditor from Purchasing Bureau, Department of Labor and Industry, and Department of Revenue records

Illustration 5

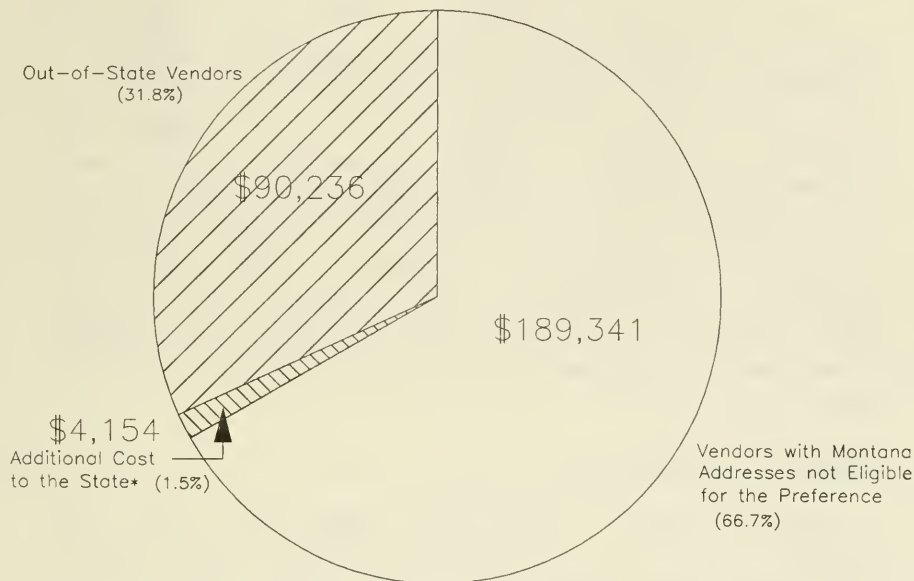
Many companies not eligible for the preference, yet with businesses in Montana, hire as many people from Montana as vendors eligible for the preference. In addition, these companies pay taxes to the state for their real and personal property. In March 1987 there were approximately 250 businesses with Montana addresses on the Purchasing Bureau's vendors list not eligible for the preference due to incorporation of the company in another state.

Vendors with Montana addresses not eligible for the preference, who responded to our questionnaire, think they should be eligible for the preference. These vendors believe they should be eligible because:

1. They pay property taxes in Montana;
2. They pay income taxes in Montana;
3. They hire Montana labor; and
4. Their place of business is in Montana.

In reviewing the effects of the preference on state government we documented which vendor would have received the contract if the preference had not been in effect. Approximately \$190,000 of the \$284,000 awarded to vendors as a result of the preference would have been awarded to vendors with Montana addresses not eligible for the preference. Because the low bid could not be accepted due to the application of the preference, there was some additional cost (approximately \$4,000) to state government for those contracts. The following illustration shows the distribution of dollar sales affected by the preference if the preference law had not been in place in fiscal year 1986-87.

SALES DISTRIBUTION IF NOT FOR THE PREFERENCE IN FY 1986-87



*This amount would not have been awarded to vendors eligible for the preference if there had been no preference.

Source: Compiled by the Office of the Legislative Auditor from Purchasing Bureau records

Illustration 6

Alternative definitions of "resident vendor" are used by some other states. Eleven of the thirty-three states with a retaliatory, percentage, or reciprocal law allow vendors with addresses in that state to receive the preference regardless of the state of incorporation of the company. Idaho law states any company domiciled outside of Idaho is considered an Idaho domiciled bidder if there exists for one year prior to bidding a significant Idaho economic presence. Significant economic presence is defined as maintaining a fully staffed office, sales office or division, or sales outlet. Manufacturing facilities, or warehouses or other necessary related property also indicate a significant Idaho economic presence.

Conclusion

Allowing only vendors incorporated in Montana to be eligible for the preference does not benefit those companies with Montana addresses not incorporated in Montana. These latter companies contribute to the economy of Montana yet are penalized when bidding for items to be purchased by state government. As indicated in Illustration 6, the preference primarily moved state government sales from one vendor with a Montana address to another.

If the intent of the preference law is to help Montana businesses, then all businesses employing Montana labor and having property located in the state should be eligible for the preference. Changing the definition of an eligible Montana vendor to include those companies with a "significant economic presence" in Montana would more closely satisfy the intent of the in-state bidders preference law.

INCREASE THE PREFERENCE

Although changing the definition of a Montana resident vendor would more closely meet the preference law's purpose of helping Montana businesses, there are other options available so the purpose may be more closely met. One option we reviewed was to increase the percentage of the preference.

Presently the preference does not substantially increase state government business to Montana vendors. One way to increase state government sales to Montana vendors would be to increase the amount of the preference. However, our audit work showed increasing the preference would have only added a small amount of business to vendors eligible for the preference in fiscal year 1986-87. In addition, the effect was similar to the present three percent preference: state business would have often just been taken from one Montana vendor and given to another Montana vendor.

For the items bid in fiscal year 1986-87, we documented the results if the preference had been up to a maximum of ten percent. We found a ten percent preference would have increased the amount spent by state government for items purchased through the Purchasing Bureau by approximately \$23,000 in fiscal year 1986-87.

Our calculations assume the bidding habits of the vendors would not change. An increase in the preference could cause vendors eligible for the

preference to submit higher bids since they would have an advantage over other vendors. If this occurred there would be a greater cost to state government than we calculated.

Illustration 7 summarizes the effects of the preference on the various types of vendors for the range of a three percent to a ten percent preference based upon 1986-87 data. Vendors eligible for the ten percent preference would have received \$622,000 more in state business than if there had been no preference. This increase would have resulted because vendors with Montana addresses not eligible for the preference would have lost \$400,000 in state business and out-of-state vendors would have lost \$200,000. The remaining increase in business to vendors eligible for the preference would have been due to an overall increase in costs because the low bids could not be accepted.

EFFECT OF THE PREFERENCE ON THE VARIOUS TYPES OF VENDORS

	PERCENT OF PREFERENCE							
	<u>3%</u>	<u>4%</u>	<u>5%</u>	<u>6%</u>	<u>7%</u>	<u>8%</u>	<u>9%</u>	<u>10%</u>
Additional Cost to the State	\$ 4,154	\$ 6,961	\$ 8,922	\$ 11,532	\$ 14,302	\$ 17,488	\$ 19,960	\$ 22,883
Decrease Sales to Vendors with MT Addressses not Eligible for Preference	189,341	267,764	293,815	322,033	350,267	371,191	381,168	396,725
Decrease Sales to Out-of-State Vendors	<u>90,236</u>	<u>95,124</u>	<u>112,301</u>	<u>131,522</u>	<u>146,105</u>	<u>167,662</u>	<u>186,969</u>	<u>202,531</u>
Increase Sales to Vendors Eligible for Preference	\$283,731	\$369,849	\$415,038	\$465,087	\$510,674	\$556,341	\$588,097	\$622,139

Source: Compiled by the Office of the Legislative Auditor from Purchasing Bureau records

Illustration 7

The major affect of increasing the preference would be to move state government sales among Montana vendors.

Questionnaire Responses

In our questionnaire we asked vendors if they thought the current preference percentage is appropriate. Of the vendors eligible for the preference who thought the preference should be increased, 67 percent (46 of 69) thought the preference should be 5 percent. Illustration 8 shows the responses of vendors eligible for the preference when asked to suggest an amount of the preference.

AMOUNT PREFERENCE VENDORS THINK THE PREFERENCE SHOULD BE

<u>Number of Vendors</u>	<u>Suggested Amount of Preference</u>
46	5%
1	6%
2	7%
13	10%
1	20%
1	50%
3	Unknown
<u>2</u>	No answer
Total 69	

Source: Compiled by the Office of the Legislative Auditor

Illustration 8

In our review of other states we found ten other states have a percentage preference applied to goods and services. Four of these states have a five percent preference. Illustration 1, page 7, details the states and the amount of the preference.

Conclusion

Our data indicates there would be a limited effect on state government purchases through the Purchasing Bureau by increasing the preference. State government would have paid an additional \$23,000 for goods and services if the preference had been ten percent in fiscal year 1986-87. The \$23,000 would probably have been higher but food contracts, one of the bigger commodities, was only awarded using an RTS for approximately three months in fiscal year 1986-87. For the other nine months food was purchased by agencies from term contracts. Also, the \$23,000 only represents sales from an RTS and individual requisitions, and it does not include sales from term contracts.

The amount of the increased cost to the state assumes the bidding habits of the vendors would not change. There is the possibility vendors eligible for the preference would increase their bids since they would have a greater advantage over the other vendors. This would increase the additional cost to the state by more than was indicated in our review.

Increasing the preference would probably not have substantial impact on the state's economy since the preference generally transfers state sales from one Montana vendor to another. Vendors for some goods and services (i.e., computers, and athletic and recreation equipment) might benefit more than others from the change since less business would go out-of-state. A ten percent preference in effect in fiscal year 1986-87, would have decreased sales to out-of-state vendors by \$200,000.

Since increasing the preference would not have had a substantial impact on vendors eligible for the preference in fiscal year 1986-87, we examined the possible effect of eliminating the preference. This option is discussed in the following section.

ELIMINATE THE PREFERENCE

This section discusses the need for the in-state bidders preference law. Only ten other states have a percentage in-state preference law in effect. Since 1973, fourteen states have repealed preference laws in their states. Our questionnaire indicated forty-six percent (101 of 219) of the respondents not eligible for the preference indicated they would like the preference eliminated.

Information from purchasing organizations gives some arguments against preference laws. These arguments include:

1. Preference laws prevent suppliers from bidding on an equal basis, thereby inhibiting competition and limiting the ability of the state and its taxpayers to procure the best possible goods and services for the lowest possible price.
2. Preference laws, by themselves, do not have a measurable long-term impact on a state's economy; only a nation-wide economic recovery can truly bolster a state's economy by helping to create jobs, increase tax revenues, and reduce unemployment and welfare costs.
3. The enactment of a domestic preference law by one state causes other states to retaliate by passing their own protectionist legislation, resulting in the restriction of interstate trade, reduced markets for goods and services and, ultimately, lost profits for domestic businesses.

Most purchases partially or completely funded with federal money are prohibited from having an in-state bidders preference applied. As stated in Chapter II, the Federal Office of Management and Budget is currently rewriting Circular A-102 to expressly prohibit the use of an in-state bidders preference for most grants to state and local governments.

Limited Number of Bids Affected by the Preference

The preference only affected 43 of the 544 Invitation for Bids (IFBs) for goods and services on the Requisition Time Schedule and individual requisitions processed by the Purchasing Bureau in fiscal year 1986-87. There are a number of reasons why the preference did not affect bids submitted for most of the IFBs. For example, ninety IFBs had only vendors eligible for the preference bidding so the preference was not applied. No vendors eligible for the preference submitted a bid for 178 IFBs. The following chart summarizes the effect of the preference on the IFBs issued in fiscal year 1986-87.

SUMMARY OF EFFECT ON IFBS PROCESSED IN FY 1986-87

	<u>Number of IFBs</u>
No vendor eligible for the preference bid	178
Only vendors eligible for the preference bid	90
Vendor eligible for the preference high or low on items so the preference was not considered	96
Vendors eligible for the preference were low for entire bid so the preference was not considered	83
Vendor eligible for the preference high for entire bid so the preference was not considered	45
VENDOR ELIGIBLE FOR THE PREFERENCE AWARDED CONTRACT AS RESULT OF PREFERENCE	43
Vendor eligible for the preference did not meet specifications, or requirements of the bid	8
Items bid on by vendor eligible for the preference were cancelled	<u>1</u>
Total	544

Source: Compiled by Office of the Legislative Auditor
from Purchasing Bureau records

Illustration 9

Vendors Total Business versus State Business

Previously we noted a limited number of vendors are affected by the preference. In addition, our questionnaire results indicate for most vendors the amount of business they do with state government is not a great part of the vendor's total business. Our questionnaire asked vendors to indicate their dollar sales, and the percentage of their total dollar sales for 1986 to state government. We found most of the vendors eligible for the preference received between 0 and \$2,000 from sales to the state, representing 0 to 3 percent of their total dollar sales in 1986. Illustration 10 shows the amount of sales compared to the percent of sales to state government in 1986 for vendors eligible for the preference.

SALES TO THE STATE IN RELATION TO TOTAL DOLLAR SALES FOR VENDORS ELIGIBLE FOR THE PREFERENCE

Total Dollar Sales	Number of Vendors by Percent of Total Sales					
	0 to 3%	4 to 6%	7 to 10%	11 to 30%	31 to 50%	51 to 100%
0 to 2,000	45	4	1	1	-	-
2,001 to 4,000	9	1	2	1	-	-
4,001 to 6,000	6	-	-	-	-	-
6,001 to 8,000	3	-	-	-	-	1
8,001 to 10,000	6	1	-	-	-	-
10,001 to 50,000	5	1	4	-	-	1
50,001 to 100,000	3	2	-	2	-	1
100,001 to over 1,000,000	2	-	1	3	3	2

Source: Compiled by the Office of the Legislative Auditor

Illustration 10

Illustration 10 indicates few vendors rely heavily on state business. Fifty-one (46 percent) of the 111 respondents who indicated a dollar amount

for sales received between 0 and \$2,000 from state government in 1986. Seventy-nine (71 percent) of the 111 respondents received 0 to 3 percent of their total dollar sales from state government in 1986. Eight (7 percent) of the vendors indicated over 31 percent of their business was with state government in 1986. Four of the eight vendors were contractors and would not be significantly affected by eliminating the preference. The in-state bidders preference has only limited effects on construction projects (see page 27). One vendor is a non-profit corporation providing vocational services to disabled individuals and is exempt from the laws relating to competitive bidding. This vendor would not be affected by eliminating the preference. Based upon our review of their type of business, the other three vendors would primarily be competing against other vendors eligible for the preference, so the in-state bidders preference would not be applied.

Preference Does Not Discourage Vendors

Questionnaire results indicate Montana's in-state bidders preference law is not significantly discouraging non-resident vendors from bidding on Montana contracts. Fifty-nine percent (129 of 219) of vendors not eligible for the preference on the Purchasing Bureau's vendor list responding to our questionnaire indicated the preference did not discourage them from bidding on contracts. Sixty-eight percent (171 of 251) of the respondents from other states not on Montana's vendor list indicated the preference has not discouraged them from bidding on Montana contracts. Many do not bid because they are not aware of how to get on Montana's vendor list. The following chart details responses concerning whether the preference has discouraged the various types of vendors from submitting bids for state government contracts.

RESPONSES TO QUESTION WHETHER PREFERENCE HAS DISCOURAGED BIDDING

	<u>Has</u> <u>Discouraged</u>		<u>Has Not</u> <u>Discouraged</u>		<u>No</u> <u>Answer</u>	
	<u>Number</u>	<u>%</u>	<u>Number</u>	<u>%</u>	<u>Number</u>	<u>%</u>
Vendors on MT's vendors list not eligible for the preference	55	25%	129	59%	35	16%
Vendors not on MT's vendor list	59	24%	171	68%	21	8%

Source: Compiled by the Office of the Legislative Auditor

Illustration 11

Impact on Contractors

Minutes from the 1961 legislative committee meetings indicate construction companies were in favor of the in-state bidders preference. Questionnaire results indicate most Montana contractors still favor the preference. Our questionnaire showed out-of-state contractors do not favor Montana's in-state bidder preference law. Sixty-five percent (20 of 31) of the respondents said it should be eliminated. Twenty out-of-state contractors said they do not think the preference helps the Montana economy.

Information gathered at the Department of Highways and Architecture and Engineering Division indicate the preference has limited effects on construction projects. Generally, if federal funds are involved in a construction project, the in-state bidders preference cannot be applied. We reviewed a sample of 100% state funded projects let during fiscal year 1986-87 at both agencies and found very few out-of-state contractors bid on projects. For the state funded projects bid on by out-of-state contractors, the bids were all much higher than the bids by Montana contractors so the preference did not come into consideration. We noted only one of the 221 projects let by the Department of Highways from January 1980 to May 1987 was awarded to a vendor as a

result of the preference. It appears eliminating the preference will have little, if any, effect on construction projects.

Conclusion

In examining the need for the preference we found the preference has a minimal affect on most of the vendors now eligible for the preference. Only 44 of the 277 vendors eligible for the preference doing business with state government in fiscal year 1986-87 through the Purchasing Bureau were affected by the in-state bidders preference. As Illustration 3, page 11, showed, Montana vendors eligible for the preference received an additional \$284,000 resulting from the preference. Vendors eligible for the preference received \$9,094,429 without the preference. The economy of Montana would not be greatly affected by eliminating the preference since, without the preference, the majority of the \$280,000 would have gone to Montana vendors anyway. Only \$90,000 of the \$9,400,000 awarded to vendors eligible for the preference would have been awarded to out-of-state vendors.

Questionnaire results show the in-state bidders preference has a limited effect on vendors. Vendors not eligible for the preference are submitting bids, and people not on the bidders list are not discouraged from applying to be on the list.

Contractors would not be notably affected by eliminating the preference. Generally, construction projects with federal funding cannot have an in-state bidders preference applied. Our review showed out-of-state contractors rarely bid on Montana projects that are 100 percent state funded.

The in-state bidders preference law had limited effect on most vendors eligible for the preference. Therefore, we believe the in-state bidders preference law could be eliminated without adversely affecting the majority of vendors eligible for the preference.

SUMMARY

If the intent of the in-state bidders preference law is to help Montana vendors by keeping a substantial amount of state business from going to out-of-state vendors, then the intent is not being met. Eliminating the preference would not adversely affect vendors eligible for the preference. We previously showed only \$90,000, out of \$9,400,000 awarded to vendors eligible for the

preference in fiscal year 1986-87, would have gone out-of-state. If a ten percent preference had been in place in fiscal year 1986-87, only a total of \$200,000 would have been awarded to eligible vendors that otherwise would have gone to out-of-state vendors. Thus, increasing the preference would not significantly help to meet this interpretation of the in-state bidders preference law.

The definition of a Montana resident vendor should be changed if the intent of the law is to provide any amount of benefit to Montana vendors. Resident vendors could be defined as those businesses with significant economic presence in Montana. These companies employ Montana labor and have property located in the state thereby contributing to the economy of Montana.

If the legislature favors having a bidders preference law, the preference would be more equitable for Montana vendors if the definition of Montana vendors included those vendors with a significant economic presence.

RECOMMENDATION #1

WE RECOMMEND LEGISLATION BE ENACTED TO CHANGE THE DEFINITION OF A MONTANA RESIDENT VENDOR TO INCLUDE COMPANIES HAVING A SIGNIFICANT ECONOMIC PRESENCE IN MONTANA.

AGENCY RESPONSE

DEPARTMENT OF ADMINISTRATION

DIRECTOR'S OFFICE

TED SCHWINDEN, GOVERNOR

MITCHELL BUILDING



(406) 444-2032

STATE OF MONTANA

HELENA, MONTANA 59620

RECEIVED

MAR 1988

MONTANA LEGISLATIVE
AUDITOR

March 8, 1988

Mary Reynolds
Senior Performance Auditor
Office of the Legislative Auditor
Room 135, State Capitol
Helena, MT 59620

Dear Mary:

We appreciate the opportunity to respond to your audit recommendation as follows:

RECOMMENDATION # 1

WE RECOMMEND LEGISLATION BE ENACTED TO CHANGE THE DEFINITION OF A MONTANA RESIDENT VENDOR TO INCLUDE COMPANIES HAVING A SIGNIFICANT ECONOMIC PRESENCE IN MONTANA.

RESPONSE

This report provides an excellent description of the effects of Montana's bidder preference. We believe that the changing of the definition of Montana resident vendors is a policy issue to be considered by the Montana State Legislature. Given the information in this report, it seems appropriate that the next Legislature consider this issue.

Sincerely,

A handwritten signature in cursive script, reading "Ellen Feaver".

ELLEN FEAVER
Director

